



Australian Bureau of Statistics

1350.0 - Australian Economic Indicators, 1993

ARCHIVED ISSUE Released at 11:30 AM (CANBERRA TIME) 13/01/1994

1993 Feature Article - Understanding Labour Costs

This article was published in Australian Economic Indicators December 1993 issue on 1 December 1993.

Introduction

Employers face a range of costs that arise as a direct result of employing labour. These costs are collectively referred to as labour costs, and will generally be a significant component of a firm's total operating costs. This article defines labour costs and then details the structure and composition of total labour costs in Australia. The focus then turns to the concept of "on-costs", or additional outlays incurred by the employer in engaging labour. The article will outline the relevant statistical information available from the ABS, and present some of the recently published results from the 1991-92 Survey of Major Labour Costs.

Components of Labour Costs in Australia

Labour costs are defined as all costs incurred by employers in the employment of labour, and can be broken down into the following components:

Wages and salaries, which are payments for ordinary time, overtime, shift and other penalties as well as payments for time not worked (paid leave and public holidays) and allowances and bonuses.

Fringe benefits, the non-cash remuneration paid to employees.

Termination payments, which are lump sum payments made to employees on termination of employment, for unused leave, early retirement packages and redundancy.

Superannuation contributions, which are in this context employer funded contributions to superannuation funds.

Workers' compensation, which include premiums paid to insurers, costs not covered by premiums (e.g. excess payments) and costs incurred by self insurers.

Payroll tax, which is tax paid in relation to employees under payroll tax legislation, net of rebates.

Fringe benefits tax, which is tax paid in relation to employees under fringe benefits tax legislation.

Training, which includes costs associated with vocational training of employees, excluding wages and salaries paid to employees providing or undertaking training.

Other costs, which include recruitment costs, the cost of transporting workers, work clothing and

welfare services for employees.

These costs can be grouped into a number of categories (footnote 1). The first is employee earnings made up of wages and salaries, fringe benefits and termination payments. These labour costs are income from the perspective of the employee. The second group are items of a social security nature that provide some future or contingent benefit to employees. The two items that fall into this category are superannuation, which provides a benefit to the employee in retirement, and workers' compensation, which provides for medical expenses and loss of earnings of employees resulting from industrial injury. While they are recorded as labour costs when the expense is borne by the employer, they are not recognised as income to the employee until resulting benefits are paid.

Payroll tax and fringe benefits tax fall into the third category of taxes associated with employment. With the exception of training, the value of the remaining items is generally considered to make a relatively small contribution to total labour costs.

The Concept of Employer On-costs

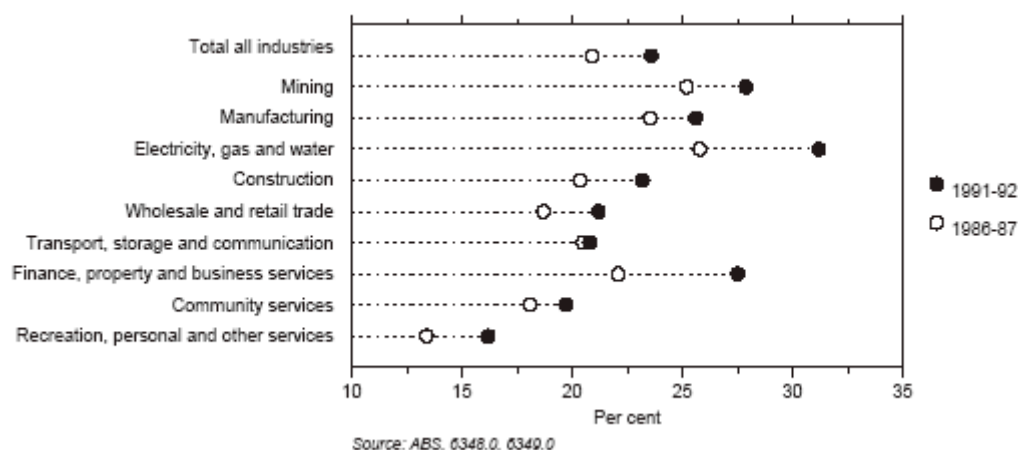
In examining labour costs, an important issue is the additional costs employers incur beyond direct payments for work done by employees. These costs are referred to as "on-costs" and can be considered as those costs for which the employer receives no direct productive return on its human capital investment. An alternative term used to describe the same concept is "non-wage labour costs" (footnote 2).

Labour costs other than wages and salaries are clearly considered by employers as on-costs. However, wages and salaries are made up of payments for time worked (direct wages and salaries) as well as a number of payments which are considered as "on-costs" from the perspective of the employer. For purposes of statistical measurement, time actually worked includes paid breaks during working hours. So, tea breaks, standby and washup time would be included as productive time. The on-cost items included in wages and salaries are remuneration paid to employees for time not worked, such as for leave and public holidays, infrequent bonuses and annual leave loading.

The importance of this concept lies in the fact that on-costs are generally subject to different influences than those affecting direct wages and salaries. On-costs are largely viewed by employers as involuntary outlays, as the most significant costs are imposed by statutory requirements or required under collective bargaining agreements. Employers are taxed on their payroll and for fringe benefits provided to employees. They are obligated to cover employees for workers' compensation and to meet minimum requirements for superannuation and training expenditure. Under the awards system, minimum requirements are stipulated for leave entitlements, leave loading and redundancy payments. As they represent a significant proportion of labour costs, increases in on-costs have the potential to affect investment decisions and ultimately, business profitability.

Labour on-costs as a percentage of total labour costs for the private sector are shown in figure 1. Over the period 1986-87 to 1991-92, labour on-costs grew as a percentage of total costs across all domestic industry groups. This is largely a result of the rise in superannuation costs resulting from centralised wage agreements and federal legislation. The sharpest increases occurred in the electricity, gas and water, and the finance, property and business services sectors. This reflects the characteristics of the labour force in these sectors as there are fewer casual workers employed than in most other sectors. The recreation, personal and other services sector, where much of the labour is not employed under award conditions, had the lowest level of on-costs relative to total costs in both 1986-87 and 1991-92.

FIGURE 1. ON-COSTS AS A PERCENTAGE OF TOTAL COSTS, PRIVATE SECTOR BY INDUSTRY 1986-87 AND 1991-92
Cost per hour worked basis



Uses of Labour Costs Statistics

The level of, and changes in, labour costs are important factors in a number of areas of economic and social concern. At a micro-economic level, labour costs affect employment practices and price structures. They are crucial considerations in issues of industry productivity and restructuring. At a broader economic level, labour costs are considered in wages, employment and industrial relations policy, prices and income policy, and social welfare policy. Labour costs are also essential in evaluating industry and international competitiveness.

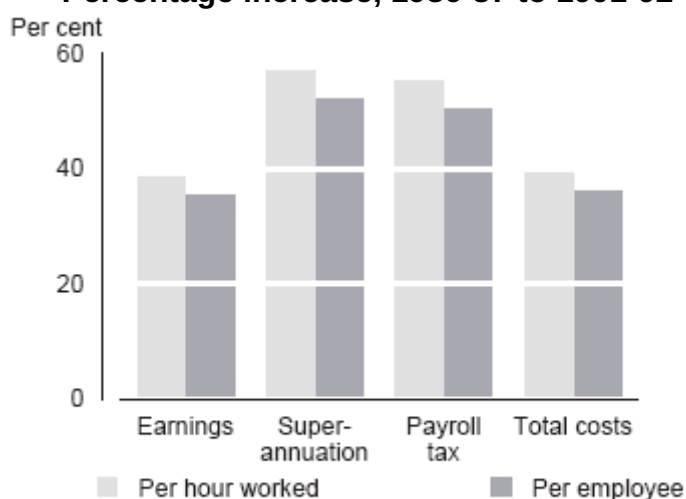
The level and composition of labour costs are primarily viewed as structural data relating to the labour market. Where used for this purpose, the collection of labour costs data is required less frequently than other labour statistics, such as employment and average weekly earnings. However, movements in labour costs in the short term are of some interest in measuring inflationary trends affecting businesses.

Measuring and Presenting Labour Costs Statistics

For statistical purposes, labour costs are measured from the perspective of the employer. So, for example in measuring fringe benefit costs, valuation is on the basis of costs to the employer, rather than the benefit value to the employee. Costs are measured on a cash payments basis. As a result, some discrepancies may exist between costs reported in statistical collections and those presented in company or public sector accounts. Where possible, labour costs are recorded net of any reimbursements, subsidies or rebates.

There are a number of ways of presenting labour costs. Total dollar costs is one form of presentation. Costs presented this way are important in examining the magnitude of labour costs, for example, in assessing the impact of government policy changes on employer costs or government revenues. For purposes of the comparison of labour costs between industries, sectors or countries, in measuring relative efficiency, average costs are more useful. Labour costs averages are presented per employee and per hour worked. While labour costs per hour worked are more difficult to produce than costs per employee, they are used by many analysts as a preferred comparative measure. In using costs per hour worked, the mix of different hours of work, for example part time versus full time, is eliminated. This basis is the international standard recommended by the International Labour Organisation (ILO) for inter-industry and inter-country productivity comparisons.

FIGURE 2. COST PER HOUR WORKED AND AVERAGE COST PER EMPLOYEE
Percentage increase, 1986-87 to 1991-92



Source: ABS, 6348.0 Annual data

Statistics on Labour Costs Produced by the ABS

Prior to the introduction of the Survey of Major Labour Costs there was little data available on labour costs other than employee earnings. Since 1985-86, labour costs statistics have been collected via the Survey of Major Labour Costs. From its inception the survey has collected total costs and costs per employee of employee earnings, superannuation, payroll tax, workers' compensation and fringe benefits tax. In the most recent (1991-92) survey the costs of fringe benefits have been included to provide a more complete view of the costs of labour. The survey collects data from a sample of several thousand employers selected from the ABS's Register of Businesses. Data from the survey can be classified by sector, industry, States or Territories, and size of employer.

Supplementary data to determine costs per hour worked and to measure the on-cost component of employee earnings have been collected twice, in the 1986-87 and 1991-92 Surveys of Wage Costs. The surveys provide a breakdown of gross wages and salaries paid to employees. Employers report the costs of paid leave (annual, sick, maternity, long service and other leave), public holidays, annual leave loading and infrequent bonuses. These components are subtracted from total wages and salaries paid, to derive payments for time worked.

While the Survey of Major Labour Costs does not cover training expenditure, it should be noted that these data are collected by the ABS Training Expenditure Survey. This survey has been conducted in reference to the September quarter 1989 and the September quarter 1990, and is currently being conducted for the September quarter 1993. Costs measured in this survey are for formal training provided by employers.

Other data on labour costs are available from the ABS's industry surveys. Wages and salaries, superannuation contributions and workers' compensation costs are often separately identified in these surveys. Other costs, however, are generally subsumed in other expenses. Recent economy wide industry surveys conducted by the ABS have collected labour costs along with other data across all industries. Data from these industry surveys provide a basis for analysing the ratio of selected labour costs to total business costs.

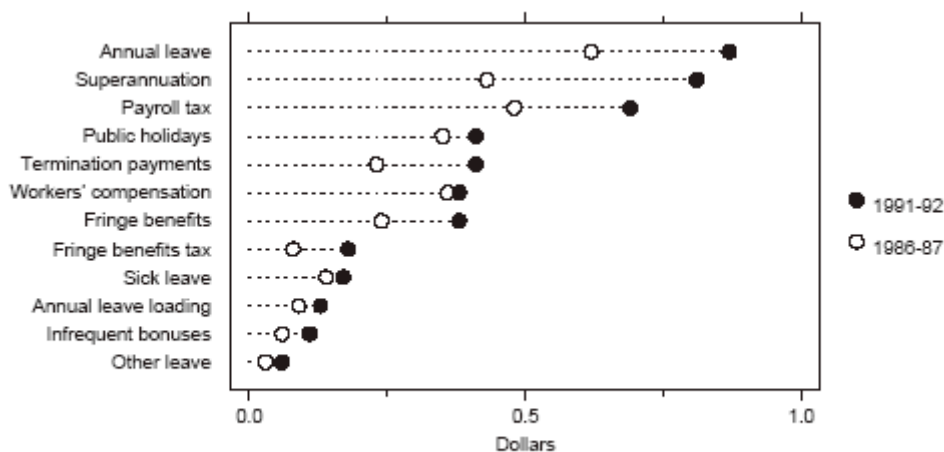
Composition and Structure of Labour Costs

Table 1 below shows labour on-costs (other earnings plus other labour costs) accounting for 25.4 per cent of total labour costs. Since 1986-87 (the last time these figures were available), on-costs (as a percentage of total labour costs) have increased by 1.7 percentage points. Figure 3 indicates changes in the relative composition of on-costs in the private sector over this period. Significant increases can be seen to have occurred in the relative importance of superannuation, termination payments and fringe benefits tax. By contrast, workers' compensation costs have decreased as a proportion of total on-costs.

TABLE 1. COMPOSITION OF LABOUR COSTS, 1991-92

Component	Cost per employee \$	Per cent of total costs
Earnings	27,581	89.0
Payments for time worked	23,126	74.6
Other earnings	4,455	14.4
Paid leave	2,121	6.8
Public holidays	711	2.3
Annual leave loading	228	0.7
Infrequent bonuses	118	0.4
Termination payments	798	2.6
Fringe benefits	478	1.5
Other labour costs	3,413	11.0
Superannuation	1,516	4.9
Payroll tax	1,086	3.5
Workers' compensation	586	1.9
Fringe benefits tax	225	0.7
Total labour costs	30,995	100.0

FIGURE 3. ON-COSTS PER HOUR WORKED, PRIVATE SECTOR, 1986-87 AND 1991-92



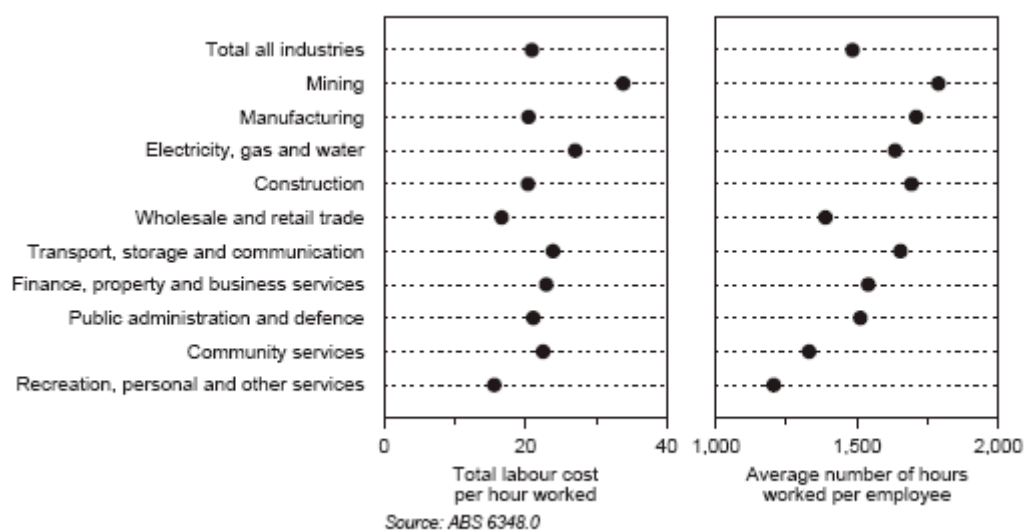
Source: ABS, 6348.0

The structure and composition of labour costs differ markedly between the private and public sectors. Employment varies considerably, as does the occupational composition of the workforce. Superannuation, payroll tax and workers' compensation costs in each sector are affected differently by legislation and administrative arrangements. Total labour costs per hour worked in 1991-92 were \$19.52 in the private sector and \$24.20 in the public sector. Private sector on-costs were \$4.60 per hour worked or 23.6 per cent of total labour costs.

Figure 4 shows the mining industry had clearly the highest total labour costs per hour worked at \$33.80. It also had the highest average number of hours worked per employee. It was followed by the electricity, gas and water industry at \$27.04 and transport, storage and communication industry at \$23.90 both of which have a high proportion of public sector employees. The recreation, personal and other services industry had the lowest total labour costs per hour

worked at \$15.62. Notably, it also had lowest average number of hours worked per employee.

FIGURE 4. COMPARISON OF LABOUR COSTS AND HOURS WORKED BETWEEN INDUSTRIES, 1991-92



The wholesale and retail trade and recreation, personal and other services industries had the lowest earnings and on-costs per hour worked. This can be attributed to the high proportion of casual, part-time and junior employees in these industries.

New South Wales and Victoria displayed higher than average payments for time worked in a number of industries including the three highest employing industries - wholesale and retail trade, manufacturing, and finance, property and business services. This contributed to New South Wales having the highest total private sector labour costs of \$20.56 per hour, followed by Victoria with \$20.26. Tasmania at \$16.66 recorded the lowest costs.

Analysis and Comments on Selected Labour Costs

This section presents some of the more interesting results relating to individual labour costs items, and some analysis of the effects of government policy and legislation.

Direct Wages and Salaries

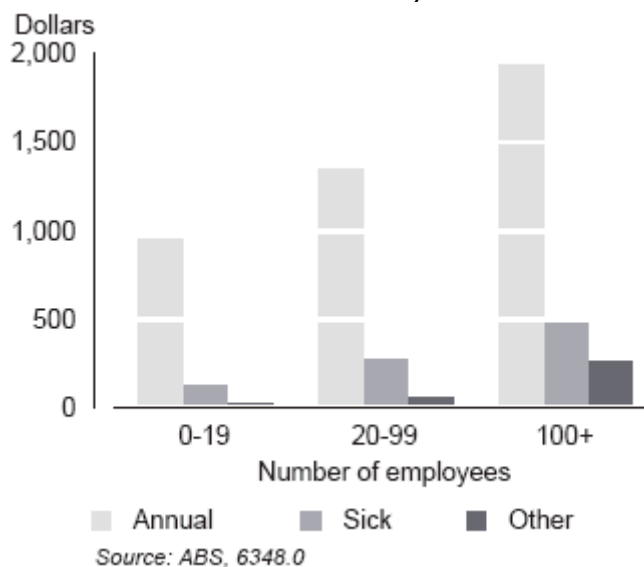
The impact of government policy on wages is complex. Detailed consideration of the issues involved is beyond the scope of this article. Broadly however, federal government influence using the centralised wage fixing mechanisms, via the Industrial Relations Commission has been a key factor influencing labour costs in the domestic economy, with the prices and incomes Accord setting the framework within which wage agreements are reached. For example, in 1990 the agreement provided for small income tax cuts to compensate wage and salary earners for cost-of-living increases, rather than a general wage increase. The current development of enterprise bargaining is likely to be a key determinant in wage outcomes in the foreseeable future. In addition, less direct effects result from initiatives in industry restructuring, efforts to control inflation and policies on international trade, particularly in relation to tariffs.

The 1991-92 Survey of Major Labour Costs highlighted some interesting features of on-cost components of wages and salaries.

Paid leave

In 1991-92, paid leave (annual, sick and other leave) accounted for 6.8 per cent of total labour costs or \$2,121 per employee. It therefore represented the largest component of costs to employers other than payments for time worked. For the same year the average hours of paid leave per employee was 144. Averages for the States ranged from 129 hours in Queensland to 162 hours in the Northern Territory, where it is common for employees to receive additional annual leave entitlements.

FIGURE 5. PAID LEAVE PER EMPLOYEE, BY EMPLOYER SIZE, 1991-92



Industry comparisons of hours of paid leave show considerable variation. The industries with the highest hours of paid leave were electricity, gas and water (221 hours) and mining (208 hours). In contrast only 64 hours of paid leave were recorded on average for employees in the recreation, personal and other services industry. These variations predominantly reflect relative employment conditions and the proportion of casual employees (who are not entitled to leave) within industries.

Paid leave per employee also varied significantly with the size of the employer. Small employers (less than 20 employees) paid for 86 hours of leave per employee, compared to 176 hours for employers with 100 or more employees.

Annual leave loading

Annual leave loading is available to most employees who are entitled to annual leave, especially those covered by awards. Leave loading is generally paid at a rate of 17.5 per cent of annual leave, up to a maximum dollar limit. Some employees receive a higher rate (for example, some mining industry employees), while others may receive additional leave entitlements in lieu of leave loading.

In 1991-92, annual leave loading payments totalled \$1,308 million (14.4 per cent of total payments for annual leave), or \$283 per permanent employee.

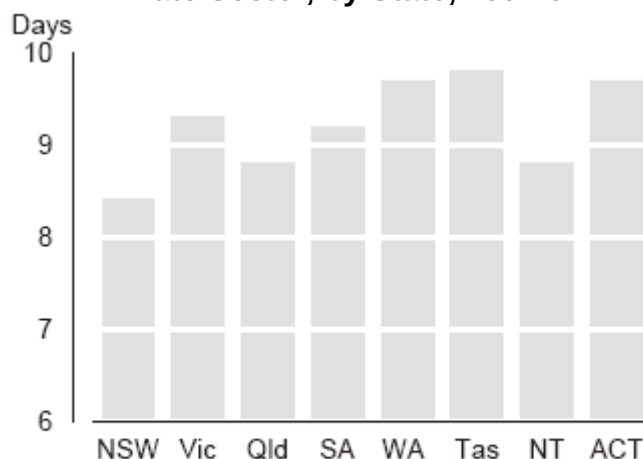
Public Holidays

In 1991-92, employees were paid for an average of 48 hours (7.6 days) of public holidays. Paid public holidays are not available to casual employees. Permanent employees were paid 59 hours

of public holidays, which is equivalent to 9.3 days. In the private sector permanent employees received the equivalent of 9.0 public holidays, while public sector permanent employees received 9.8 days, reflecting an additional public sector holiday available to most employees.

As shown in figure 6, averaged across all employees Tasmania had the highest number of public holidays per permanent employee, closely followed by Western Australia and the Australian Capital Territory. These figures reflect the varying levels of casuals in the States - those States with lower levels of casuals recorded higher average hours and vice versa.

**FIGURE 6. NUMBER OF PUBLIC HOLIDAYS PER PERMANENT EMPLOYEE
Private Sector, by State, 1991-92**



Source: ABS, Unpublished

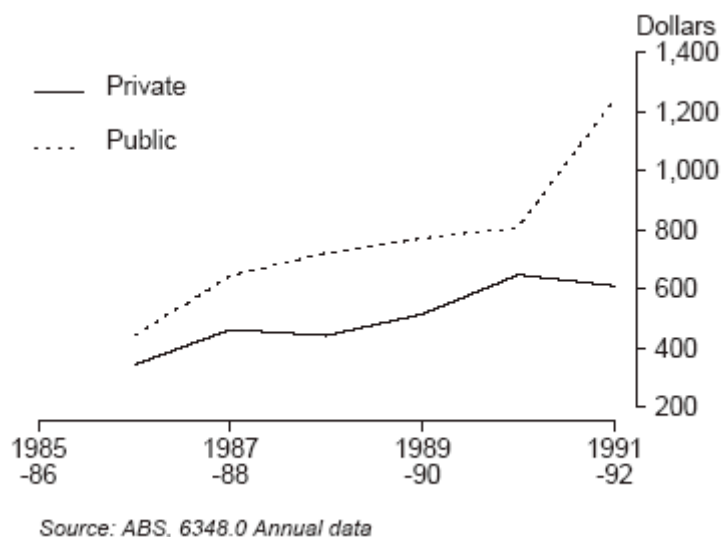
A similar effect is evident across industries, where the recreation, personal and other services and wholesale and retail trade industries with traditionally high proportions of casuals recorded the lowest hours for public holidays. The mining and electricity gas and water industries on the other hand were high. The public administration and defence industry also recorded high hours of public holidays per employee.

Termination Payments

In 1991-92, termination payments accounted for 2.6 per cent of total labour costs. This represented an average of \$798 per employee, up 14.3 per cent on 1990-91.

The effect of decisions by employers to shed staff during the recent recession can be seen in figure 7. In the private sector, termination payments dropped 5.5 per cent, after peaking at \$650 per employee in 1990-91.

FIGURE 7. TERMINATION PAYMENTS PER EMPLOYEE, 1986-87 TO 1991-92



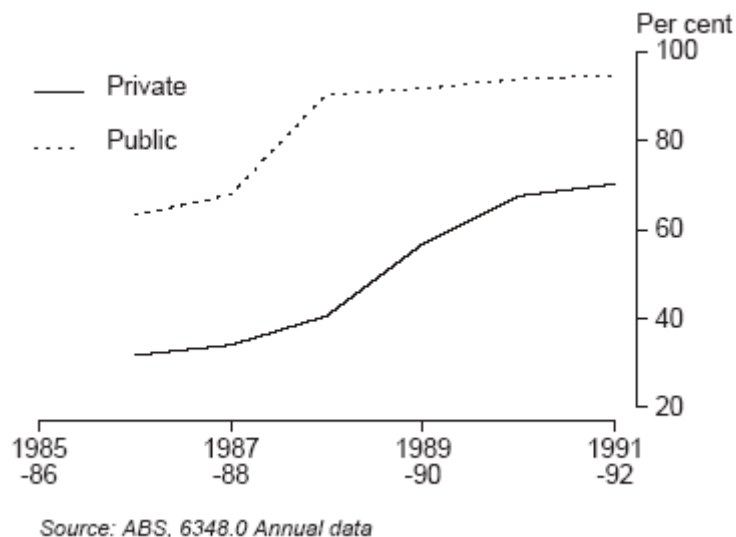
In contrast to the private sector, the public sector recorded an increase of 52.8 per cent in 1991-92, after relatively little movement since 1988-89. The increase stemmed from a significant rise in termination payments for the Commonwealth Government. Notable increases also occurred for State governments in Victoria and Western Australia.

Superannuation

Significant changes to employer liabilities for superannuation have occurred since the mid-1980s. When the 1986 National Wage Case awarded a productivity linked pay rise to be paid as superannuation contributions, it provided for a minimum level of superannuation for employees covered by awards. This produced an immediate jump in superannuation coverage in the public sector to over 90 per cent. In the private sector, coverage expanded progressively through awards over the subsequent four years, with the growth in coverage slowing in 1991-92 to reach a level of 70.3 per cent. The Superannuation Guarantee Charge, introduced from 1 July 1992, is expected to increase coverage and contribution levels further as superannuation extends to non-award employees not previously covered and minimum contribution levels are increased.

The effect of changes up to the end of 1991-92 can be seen in the rise in private sector superannuation contributions, from \$2,969 million in 1987-88 to \$4,849 million in 1991-92. Superannuation contributions per employee rose from \$707 to \$1,196 over the same period.

FIGURE 8. SUPERANNUATION COVERAGE 1986-87 TO 1991-92



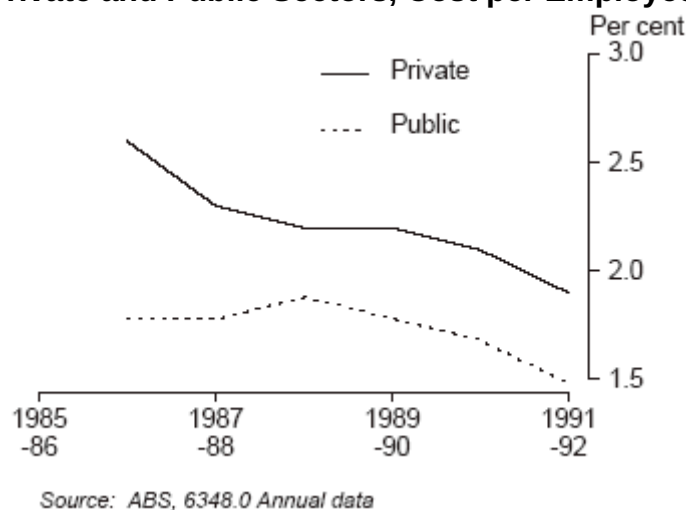
Workers' Compensation

Workers' compensation insurance is compulsory for all employers.

Due to an increasing burden on governments and the community, there has been pressure in recent years to reform workers' compensation arrangements in Australia. This has resulted in improved workplace safety and an increasing acceptance of the need for effective rehabilitation of injured workers. Increased efforts by governments to reduce costs have led to more efficient administration of workers' compensation schemes. As figure 9 shows, workers' compensation costs expressed as a percentage of total labour costs, has been falling for both the private and public sectors.

FIGURE 9. AVERAGE WORKERS' COMPENSATION COSTS AS A PERCENTAGE OF TOTAL LABOUR COSTS

Private and Public Sectors, Cost per Employee

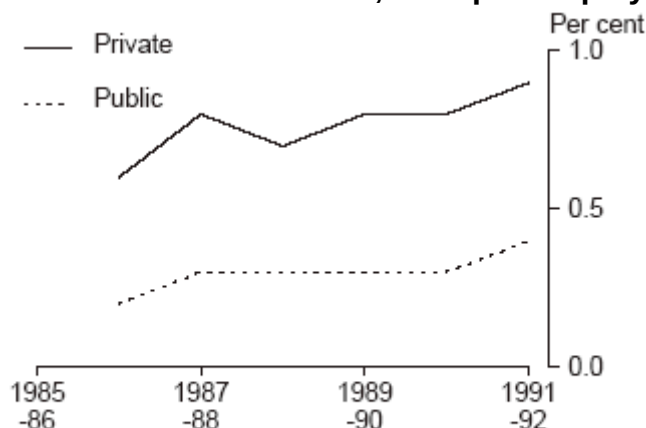


Fringe Benefits Tax (FBT)

Taxation of fringe benefits was introduced by the Commonwealth Government in 1986 to increase tax revenue on non-cash remuneration paid to employees. From 1986-87 to 1991-92, the proportion of employers' total labour costs expenditure has risen from 0.6 per cent to 0.9 per cent in the private sector and from 0.3 per cent to 0.4 per cent in the public sector.

FIGURE 10. AVERAGE FRINGE BENEFIT TAX COSTS AS A PERCENTAGE OF TOTAL LABOUR COSTS

Private and Public Sectors, Cost per Employee



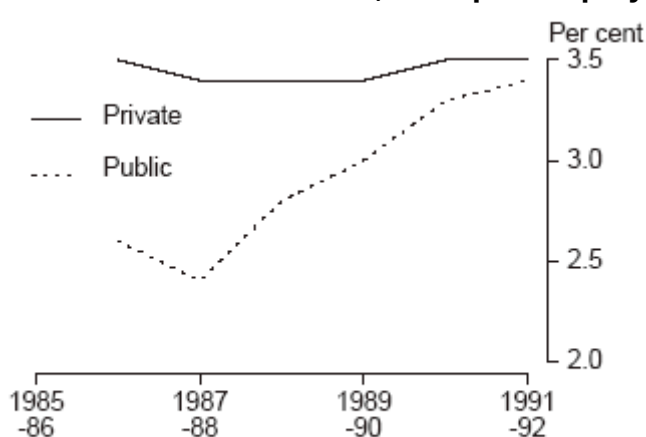
Source: ABS, 6348.0 Annual data

Payroll Tax

Every State and Territory in Australia collects payroll taxes. State payroll taxes are subject to the policy priorities of individual States, and therefore differences exist in their application in each State. Payroll thresholds from which payroll taxes apply, and the rates at which the taxes are paid, vary in each State. Payroll tax rebates and concessions are used in some as an incentive to develop selected industries.

FIGURE 11. AVERAGE PAYROLL TAX AS A PERCENTAGE OF TOTAL LABOUR COSTS

Private and Public Sectors, Cost per Employee



Source: ABS, 6348.0 Annual data

From 1990-91 to 1991-92 State Government revenues from payroll tax paid by private sector employers increased 4.1 per cent to \$4,154 million. The most significant increase occurred in the Australian Capital Territory, which rose 34.2 per cent. New South Wales and Victoria recorded rises of 6.0 per cent and 6.2 per cent respectively; while in Tasmania payroll tax payments fell 9.9 per cent.

As payroll tax is levied above a prescribed payroll threshold in each State, the incidence of

payroll tax increases with the size of employer. Only 5.3 per cent of employers in the 0-19 employees size group paid payroll tax in 1991-92, while 88.7 per cent of employers with 100 or more employees paid payroll tax. Most employers not paying payroll tax in this group would be organisations exempt from the tax such as religious institutions and non-profit organisations.

Conclusion

The article has examined the concept of labour costs, with a focus on the "on-costs" incurred by employers, and has noted the effect of government policy and charges on some of these costs. It has been pointed out that the different components of total of labour costs are subject to differing influences, for example over recent years superannuation has assumed a major role in Australian industrial relations and government labour and social welfare policy.

This feature article was contributed by Geoff Neideck, Labour Costs section, ABS.

Footnotes

1. The grouping of labour cost items used here is based on the ILO International Standard Classification of Labour Costs. < Back

2. The terms "on-costs" and "non-wage labour costs" are sometimes used to refer to labour costs other than total employee earnings, rather than all labour costs other than payments for time worked. < Back

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